



Philequity Corner (May 22, 2017)

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Politics vs. Economics

Last Wednesday, the Dow dropped 373 points and the S&P 500 slid 1.8%. For both indices, it was their worst one-day performance since September 2016. The drop in US stocks was caused by political uncertainty emanating from Washington, on reports that a possible impeachment against Trump is forthcoming. Thus, the concern for investors is that prolonged political turmoil may stall the implementation of the Trump administration's economic agenda.

Comey vs. Trump

The recent political turbulence was sparked by a memo issued by ex-FBI Director James Comey, who was fired by Trump last week. Shortly after his firing, Comey wrote a memo detailing his past conversations with Trump. In his memo, Comey alleged that Trump asked him to halt an FBI investigation on Michael Flynn, Trump's former national security adviser, for supposed links with the Russian government. Many have commented that this was a clear obstruction of justice by Trump, which raises the possibility of an impeachment proceeding against the US president.

Previous US impeachments and market effect

In recent memory, there were two impeachment proceedings that were initiated against US presidents – Richard Nixon in 1974 and Bill Clinton in 1998. Though the circumstances were different, both proceedings triggered sharp corrections in US stocks. The Congress halted the impeachment proceeding when Nixon resigned, while Clinton was impeached by Congress but was acquitted by Senate. In Nixon's case, the S&P 500 dropped by more than 40%, as this was a time when the stock market was going through a vicious bear market. In Clinton's case, the S&P 500 corrected by ~20% but ultimately staged a recovery as underlying economic conditions then were strong.

Impeachments in the Philippines

In the Philippines, the case against Joseph Estrada is an example of an impeachment proceeding which hurdled Congress and reached Senate for deliberation. Erap's impeachment trial triggered a steep market correction, which was followed by a sharp recovery after his resignation from office. Both Gloria Arroyo and Noynoy Aquino had to fend off multiple impeachment cases against them, though these never really prospered and were easily quashed by Congress.

Duterte impeachment quashed

Despite being relatively new to the position, President Duterte has already been the subject of an impeachment complaint. But in a show of control, the House Committee on Justice voted unanimously to quash the impeachment case against Duterte last week.

No respite for Brazil

Impeachment proceedings happen in many democracies. After impeaching ex-President Dilma Rousseff on corruption allegations, Brazil is facing another political scandal implicating its current President,

Michel Temer. Brazilian newspaper O Globo recently reported that Temer gave his blessing for a pay-off that would silence a witness in an ongoing corruption scandal. This caused an 8.8% decline in the Bovespa Stock Index and a 16.3% drop in EWZ (ETF for Brazilian stocks) last Thursday.

Politics may hinder Trump agenda

In our previous articles, we explained how the US market reached new all-time highs due to excitement about Trump's pro-growth agenda (*The Trump Card*, December 12, 2016 and *20,000*, February 6, 2017). Trump's agenda is focused on implementing a tax reform program and hiking infrastructure spending to stimulate economic growth. But given recent developments, US politics may take centerstage and the implementation of the economic agenda may go into limbo. A protracted impeachment proceeding will serve as a distraction from the implementation of important economic reforms.

On the other hand, Trump's removal from office, whether due to impeachment or resignation, may propel markets higher. Mike Pence, incumbent Vice President and next in line to the presidency, is less controversial, less combative and is more acceptable to the general public.

Betting on a Trump impeachment

Amazingly, betting occurs not only in sports and elections, but also for the outcome of a potential Trump impeachment. This goes to show that anyone can bet on anything under the sun. Recently, oddsmakers experienced an influx of bets on a possible Trump impeachment. Some of the betting websites are pegging the odds of a Trump impeachment at 33%, up to a high of 55%. The rising odds show that better interest over the Trump scandal is growing and the probability of a Trump impeachment is increasing as the days go by.

Trump and Duterte, similarities and contrasts

In a past article, we discussed the many similarities between Trump and President Duterte. Both have unorthodox and unpredictable personalities. In addition, Trump and Duterte followed a similar path to power and scored stunning upsets to win the election. Their economic agendas also have a lot in common, as both are focused on implementing tax reform and undertaking massive infrastructure spending to stimulate growth (*Year of the Underdogs*, November 14, 2016).

However, their paths have started to diverge recently. On the one hand, Trump will likely experience a tumultuous time dealing with Comey's memo. He appears to be losing control of the US political landscape, which would compromise the implementation of his pro-growth agenda. On the other hand, the impeachment complaint against Duterte was quashed by Congress last week. With firm political control, the Duterte administration is in excellent position to implement its economic agenda. In fact, the tax reform package is nearing passage in Congress. Recently, the country's economic managers and infrastructure officials went on an international roadshow to promote the government's ambitious infrastructure program (*Build, build, build!*, April 24, 2017).

US investors can learn from the Philippines

While the mentality of many Filipinos is to emulate the US and learn from the Americans, there are instances when the opposite can happen. There are times when US investors can learn from us. In early-2008, we said that US investors can study the experiences of the Philippines during the Asian financial

crisis in order to better navigate the US subprime crisis and profit from it (*The US can learn from the Asian financial crisis*, January 21, 2008).

US investors can also examine and study the experiences of Philippine investors in the past year or so. In the latter part of 2016, the Philippines dealt with negative headlines from major local and international dailies. While these caused Philippine stocks to correct last year, the PSEi is now up 13.6% year-to-date, making it one of the best performers globally.

Philippines rejects EU grant

Last week, the Philippine government rejected an EU grant, as it came with certain conditions which the government does not agree with. Will this negatively affect our relationship with EU countries, or will the grants from China and Japan offset this loss? Is this merely political noise or will this materially affect the economy? This is something that we will have to monitor closely.

Ignore the noise, focus on economics

Political turmoil results in uncertainty, which may lead to investor anxiety and market corrections. To assuage concerns from the market, the country's top economic managers came out with statements, urging investors to ignore the noise and focus on economics. At the height of the political controversies last year, Finance Secretary Sonny Dominguez said, **"If one is able to see through the noise created by negative headlines, he may have a better and comprehensive understanding of the exciting and positive changes ahead of the Philippines."** More recently, BSP Governor Amando Tetangco, Jr. stated, **"There seems to be a decoupling of economic performance and political noise. The economy has continued to perform well."** Our country's economic growth remains strong, with 1Q17 GDP coming in at 6.4%. Though this fell below market expectations, it is still one of the fastest growth rates in Asia.

Don't mix politics with investments

In the aftermath of Trump's election, famed investor Warren Buffett said, **"If you mix your politics with your investment decisions, you're making a big mistake."** Ultimately, investors have to gauge how much of politics will actually affect economics. If the political issues are just noise and will not derail the economy, then these should not alter one's investment strategy. Thus, in the case of the Philippines, one may have missed the PSEi's strong rally this year if he focused on politics and disregarded economics. This shows that investors should understand politics in terms of how it affects economics and corporate fundamentals. **Though high-profile scandals and political noise can cause corrections in the short-term, the stock market will continue to move higher in the long-term if the underlying economic growth remains strong.** Thus, our advise is for investors to stay the course, for as long as politics does not result in bad economics and deteriorating fundamentals.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.